



The sale of the Portuguese operations of Carrefour

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September 2014

Dissertation submitted in partial fulfilment of requirements for the degree of MSc in Business Administration, at the Universidade Católica Portuguesa, September 2014.

Abstract

Title: The sale of the Portuguese operations of Carrefour

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In 2007, Carrefour decided to put up for sale their Portuguese operations, consisted of 12 hypermarkets, 11 licenses to open new stores and 8 gas stations. Many things were speculated during the process, but in the end Sonae ended up buying the operations for 600 million euros. This case study provides insights about the food retailing market at the time and an overview of the top 3 players in Portugal, Sonae, Auchan and Jerónimo Martins. The main goal of this thesis is a reflection about the advantages, disadvantages and what would happen if any of the other two would have bought it instead of Sonae. The financial situation of the companies is analysed, as well as their investments, their assets and their location, their portfolios and their strategies. In the end, there will be presented a conclusion about which company would have benefited the most from this deal.

It is given in the case all the information the reader needs to have a clear vision of the market at the time, the companies and to draw his own conclusions about what happened and what could have happened.

Key-words: merges, acquisitions, retailing, Carrefour

Resumo

Título: A venda das operações do Carrefour em Portugal

Autor: Miguel Vieira da Rocha

Em 2007, o Carrefour decidiu pôr à vendas os seus ativos, que consistiam em 12 hipermercados, 11 licenças para a abertura de novos e 8 postos de combustível. Muito foi especulado durante este processo, mas no fim acabou por ser a Sonae a vencer, pagando 600 milhões de euros. Esta caso apresenta considerações sobre o mercado do retalho alimentar na altura e uma apresentação das 3 maiores empresas neste sector, a Auchan, a Jerónimo Martins e a Sonae. O principal objectivo desta tese é a reflexão sobre as vantagens, desvantagens e sobre o que teria acontecido se alguma das outras empresas, que não a Sonae, tivesse ganho a compra do Carrefour. É analisada a situação económica das empresas, os seus investimentos à época, quais os seus ativos e a sua disposição geográfica, os seus portfólios e as suas estratégias. No fim, para concluir, é defendido que uma das 3 empresas seria a mais beneficiada com este negócio.

No caso é dada toda a informação que o leitor precisa para ter uma visão clara sobre o sector em 2007, sobre as empresas e sobre toda a informação que precisa para chegar às suas próprias conclusões sobre o que se passou e sobre o que se podia ter passado.

Palavras-chave: fusões, aquisições, retalho, Carrefour

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Acknowledgments

I would like to thank all the people that helped me directly, or through support, with the challenge that was preparing this thesis.

First, I would like to thank the most important person, my thesis advisor, professor João Simão Pires, for all the guidance through this process and for always challenging me to question every piece of information and not to be afraid to pursue what did not seemed to be the obvious path. Without him this thesis would not be half as interesting.

Second, I would like to thank all my colleagues with whom I exchanged ideas, concerns, fears and plans, and also helped me to finish this journey. This group includes not only the people who attended my seminar, but also my closest friends who are, or were, going through the same thing as I was.

Last but not least, I would like to thank all my friends that bring balance to my life and keep me happy, my girlfriend for being so patient with me, and my family for asking me every day "when, for god's sake, are you going to finish your thesis."

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Case Study

1. Introduction

In early 2005, in the Carrefour's headquarters in Levallois-Perret, France, an important decision had just been made. In order to face an intensified competition, a decrease in consumer expenditures in Europe and the extremely volatile regulatory system in France, Carrefour was forced to rethink not only their economic model and strategy, but also their ambitions and goals. To make it happen, the group stopped focusing on marginal growth opportunities in order to focus on long term growth opportunities and results. The intention was to turn a short-term oriented company into a long-term oriented one. The mission was clear: to be in the top three players in the retail distribution sector in every market they were in. They wanted to focus all their resources and efforts on their new strategic assets, those that had a greater potential for profitability and growth. To make this happen, they knew they had to let go of some markets and invest heavily in some other ones. While restructuring the group's operations, they quickly exited a few markets, more precisely the Japanese, the Mexican, the Czech and the Slovakian. They also ended two types of activities where they could no longer support a leadership position: the catering outlets in France and the cash & carries in Spain. Following this strategy, the day came when it was time for the Portuguese operations to be sold. Portugal was not, by any means, one of the targeted markets that fitted the company's strategy. They were relatively small in size and consequently far from the top three in sales. The Portuguese operations only represented 0.6% of the sales of the whole group and the market was already in a maturity stage of development. Since 1992, when Carrefour Portugal began, they never managed to be in the top 3 retailer positions, and in such a saturated market and with the hypermarket format declining, Portugal could not fit the group strategy anymore.

In July 2007, Carrefour announced that they were selling the Portuguese assets and the bidding began. This sale included 12 hypermarkets, 11 licenses to open new ones and 8 petrol stations. The press indicated that another French group, Auchan, was considered as the most probable buyer, but Jerónimo Martins and Sonae Distribuição were also contenders. Even without Carrefour being one of the biggest players in the food-related retail and distribution market, these top 3 players are very close to each other in terms of market share. The acquisition of a smaller player would be enough to significantly change the ranking of the top players. Sonae Distribuição could increase the gap to the

rest of the companies and reinforce its position, or Jerónimo Martins and Auchan could take advantage of this sale to catch up with Sonae in the leadership.

2. The market

2.1. Industry

The food-based retailing market consists on the distribution of food and home products that satisfy the daily consumption needs of the families. The stores can have different formats, depending on the dimension, services and range of supplied products, and can be classified as hypermarkets, supermarkets, hard discount stores, mini-market, convenient stores, specialized stores, traditional commerce, e-commerce, catalogue, etc. [6]

This sector is highly sensitive to the global and national economic climate. The predicted economic scenarios are naturally highly uncertain and volatile, which increases the time factor when analyzing long-term investments. The financial market demands higher risk premium shares and more transparency and selectiveness in long-term investments. This makes investments that have a longer payback period more restricted and expensive. It is expected that this trend will increase in the following years, which makes the access to credit more restrictive and increases the probability of a company not being able to pay back its debts.

The food retailing market is evolving to become more responsive to the quick evolution of markets and consumers, which are becoming more demanding and favoring reliable brands and competitive prices. This will require a readjustment of the strategic planning of the companies present in this market, either in the type of investments or in the duration of such investments. Short term investments and the reinforcement of the respective own brands seems like the best way to spend a big retailer investment funds in this scenario.

Lately, consumers have been showing an increased rationality in their purchase decisions related to food products, spending more time gathering information and evaluating the different alternatives. As a reinforcement to what was previously stated, the price sensitivity has been increasing, as well as the concern about quality, safe and healthier products. Regardless of the different nature of the sub-markets in the food-retailing segment, the search for more convenient solutions has been stronger in the last years, which increases the importance of the number of stores and their location in the strategic planning. The concentration into highly populated areas and the decrease in the working

class spare time to dedicate to these matters take part in this situation and are probably the most important factors.

Looking at a broader view of the consumers, society has been evolving to an older and diversified structure, due to the aging population problem and the increased racial and cultural plurality. This will require a more diverse range of products supplied or a more focused one, depending with which target each retailer wants to work for. The food-retailing market became highly competitive, with constant aggressive pricing and different formats and supply. This applies to developed countries, which is the Portuguese case.

The different formats can be competitive under different parameters, such as price, quality, range of products, service level and location. Each store can differentiate itself in each one of these parameters. Two formats are included in the same market if a meaningful part of the customers switch to the competitor in response to a small but significant raise in the prices of the other one. For such thing to happen, the competitiveness of both players has to be, if not similar, not far from each other to the majority of the customers.

Key Attributes	Price	Convenience	Diversity	Service
Formats in competition	Hypermarket Supermarket Discount stores	Supermarket Discount stores Traditional retail	Hypermarket Supermarket	Hypermarket Supermarket Discount stores
Non-substitutes	Traditional retail	Hypermarkets	Traditional retail Discount stores	Traditional retail

Figure 1 - Key attributes and competitiveness between retail formats.

Source: Sonae Distribuição

2.2. International

The food-retailing market at a global level has been growing in terms of attractiveness and profitability, in spite of the increased competitiveness at a global scale. The sector has been concentrating itself in the last years, but keeping the biggest retailers rankings nearly intact. The only changes are the replacement of Metro by Tesco in the fourth place and the fact that Ahold is no longer in the top 20, as a result of the portfolio restructuring process it has been implementing for the last few years.

The fast growth and dynamism of markets like Russia and China brought some of their local retailers to the global top 250. The eastern European market also attracted many big players: Tesco entered Slovakia and Lidl entered Slovenia and Croatia. Carrefour opened their first supermarkets in Romania and was planning to open the first in Bulgaria and Russia in the following year. While Auchan was the first foreign retailer to enter the Ukrainian market, Aldi entered Croatia, started a company in Czech Republic and was planning to enter Poland, Hungary and Greece in 2008. In the Asian market, Wal Mart entered the Indian market and, like Carrefour, is planning to enter the Chinese market soon. Between the developed markets, Whole Foods (American) entered the British market, while Tesco (British) entered the American market under a new concept, *Fresh & Easy*. [8]

2.3. Market Consolidation

The German retailer Tengelmann sold all their food retail operations, which were bought in Portugal and Poland by Jerónimo Martins. Carrefour sold in that year their operations in Slovakia and the Czech Republic. Ahold exited the Polish market by selling their assets to Carrefour and sold part of their businesses in the United States, particularly the hypermarkets Top Market, to Morgan Stanley Private Equity. Casino did something similar by selling Leader Price to Tesco and their hypermarkets Geant to Metro in Poland, and *Smart & Final* in the United States.

In some geographical markets, there was not only organic growth but also many acquisitions between retailers from the same country. In Russia, X5 Retail bought 2 smaller retailers, Korzinka and Strana Gerkulezsia, which increases their network by 51 new stores. In Spain, the supermarket group Caprabo sold 75% of their capital to Eroski and in Germany, Rewe bought 122 stores from the Edeka group. [8]

2.4. New Concepts

Spain was the most important market in 2007 regarding format innovation and new concepts, mostly proximity concepts. Carrefour launched the Carrefour City and Dia Market, both trying to expand the original brand strengths to the convenience store format. Also in Spain, Lidl opened their first store with 3,000 square meters. In Manchester, Aldi launched a new concept focused in fresh products and Tesco took something similar to the United States, under the brand of *Fresh & Easy*, by selling mainly fresh products at low prices. After being launched by some American retailers, Tesco is studying the

hypothesis of starting to offer basic medical assistance, some basic check ups like weight, cholesterol, diabetes and blood pressure. [8]

2.5. National

If we look at the trends over the last 25 years, we can see that the hypermarket format increased in popularity from 1987 to 1995, when it started to lose market share to the supermarkets and the hard discount format was introduced. By the end of the 90s, chains of specialized stores also started to gain popularity. We are talking, for example of Toys'R'Us (toys), Decathlon or Sportzone (sports goods), Vobis or Worten (electronics), or Leroy Merlin (home improvement and gardening). The previous concept of the hypermarket used to gather all this in the same place with food, hygiene and daily products, which meant bigger surfaces and less variety of each one. People started moving from the traditional hypermarkets to the supermarkets to purchase daily products for convenience and to hard-discount stores for lower prices. When in the need of something more specific, people started to opt for the chains of specialized stores since they offered a wider range of products, at reasonable prices and usually with less risk of backlog. To face this trend, the hypermarkets naturally converted themselves into giant supermarkets, focusing in offering the widest range possible of daily products and dropping the specific products that the customers started to buy in other stores.

From 2005, and according to the predictions at the time, the supermarkets were starting to lose market share, the hypermarkets kept on losing and the hard discount stores kept on gaining those market shares. The traditional commerce, which started with 75% of market share in 1987, was permanently losing share and it was predicted that it would end up with only 7% in 2015.

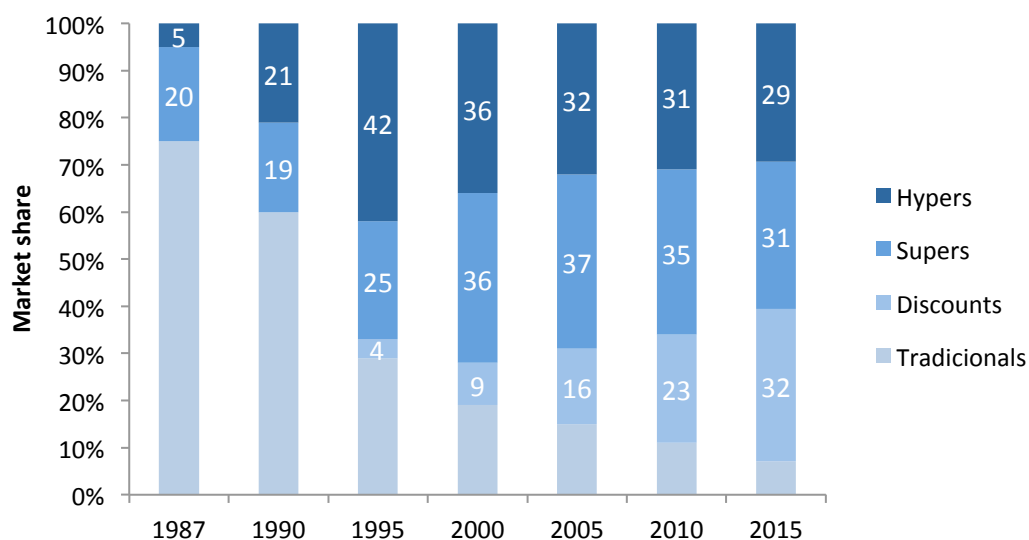


Figure 2 - Evolution of the market share of the different formats.

Source: Sonae Distribuição

By competing in the same market and by trying to adapt to consumer preferences, the remaining formats have been repositioning themselves in order to be able to compete in price with the hard discount retailers. The hard discount retailers answered by improving the service level to match the hyper and supermarkets, investing in parking areas, advertising, credit, etc.

	hypermarkets	supermarkets	discount stores	others
hypermarkets	-	80-90	80-90	80-90
supermarkets	90-100	-	90-100	90-100
discount stores	90-100	90-100*	-	90-100
others	85-95	85-95	85-95	-

Figure 3 - Clients of one format that also purchase in other formats.

Source: TNS World Panel

The table above contains the percentages of clients of a certain format (horizontal) that also purchase in other formats. For example, the value of the cell marked with * means that between 90% and 100% of the clients that go shopping in supermarkets also go to discount stores.

This situation contributed to the narrowing of the supply diversity. It increases the substitutionability of the suppliers in the eyes of the consumers, which increases competition and is reinforced by the perception that the service is somehow increasingly similar among competitors.

By neutralizing the other dimensions of the competition, this market is essentially competing through the price.

	2006	2007
Always lowest price	35%	26%
Good price/quality ratio	19%	24%
Fresh quality products	8%	13%
Good promotions	11%	9%
Wide range of products	-	5%
Good hygiene	6%	-

Figure 4 - Most important reasons to chose a store.

Source: GfK

To the table above, the lowest price, the price/quality ratio and the promotions can all be considered as price motives. Interpreted as a group, there is smaller decrease of the importance of the price to choose a store, from 65% to 59%, than if only the lowest price is considered as a price motive. It is also important to notice that the location factor is not in this table, but it is considered as an important one.

Group	Sales (in Billion €)	Market Share
Sonae	2.7	18%
J. Martins	2.3	15%
Intermarche	1.6	11%
Auchan	1.3	9%
Lidl	1.1	8%
Minipreço	0.8	5%
Carrefour	0.5	3%
Total	10.3	69%

Figure 5 - Sales and market share of the biggest retailers in 2007.

Source: APED

The figure 5 shows how the market leader only has 18% of the market share in sales and how with the other 6 main players it is not more than 70% of the market.

3. Carrefour Group

Carrefour is primarily a retail distribution group, established since the first supermarket opened in Annecy, France, in 1960. By the year 2000, Carrefour merged itself with the also French company Promodés and found a place among the world's retailer giants. It now consists of a network of hypermarkets, supermarkets, hard discount stores, cash-and-carry stores, convenience stores and e-commerce platforms. By 2007, the group had stores in Europe, Asia and Latin America, representing an aggregated sales value of 82 billion euros. These sales were made mainly in hypermarkets (62%), supermarkets (21.5%) and hard discount stores (10.5%), and in France (45.8%), remaining Europe (37.5%) and Latin America (10%). By crossing these values with the distribution of the stores presented in the table below, it can be seen that the biggest percentage of the sales came from a retail format (hypermarkets) that only represents 14% of the total stores and from a region (France) that only represents 21% of the total stores.

	Hypermarkets	Supermarkets	Discount Stores	Other formats	Total
France	194	604	840	61	1.699
Rest of Europe	399	957	3.136	229	4.721
Latin America	255	141	572	5	973
Asia	238	-	275	-	513
Total	1.086	1.702	4.823	295	7.906

Figure 6 - Number of Carrefour stores by format and geography.

Source: Carrefour 2007 Annual Report

As it can be seen, in Europe, excluding France, Carrefour was represented mainly through discount stores (66.4%), while the hypermarkets represented only 8.5% of the network in Europe.

Even though Carrefour is one of the biggest retail groups in the world, they give their regional units a considerable degree of independency, empowering them to manage their stores considering local markets specificities. The majority of the products are bought from local producers and the local stores only buy through the central purchasing unit when there is a clear economic advantage. The autonomy of each local unit does not only bring more responsibility, which brings commitment, but also allows each unit to be more responsive to their own local reality. Each unit is responsible to manage its own portfolio of products, the relationship with each supplier, objectives and goals. Short and medium term strategic decision-making is done locally and the long term strategy, financial planning and technical issues are the responsibility of the headquarters.

Carrefour entered the Portuguese market in 1991, by acquiring 2 Euromarché stores, which were players in the hypermarket sector. In 2007, with only 12 hypermarkets, being positioned in ninth regarding total store area, Carrefour managed to be classified as the sixth biggest retailer in sales volume. This high volume of sales per m², reveals that the Carrefour group made some right decisions in the years before. Looking at what and how the customers value in a food-related retail store, we can assume that the position of the Carrefour stores is pretty strong. This strong asset is easily transferable to the potential buyers and can only be slightly diminished if the buyer already has a store nearby. [4]

In 2006, the 12 hypermarkets made 442 million euros in sales and the 8 petrol stations made 88 million euros. [5]

4. Sonae Distribuição

Sonae Distribuição is the sub holding of the Sonae group that deals with the retail and distribution. It started in 1985, when the first hypermarket in Portugal was born, Modelo (Matosinhos), a joint venture with the french group Promodès. This hypermarket definitely changed the way the Portuguese people faced the retail from that moment on. This was the perfect alliance between a company that had expertise in this type of format and a company that was already a big player in the Portuguese economy. The success brought the expansion to other regions of Portugal and formats.

In 1998, Carrefour bought Promodès and Sonae Distribuição ended up in a strange situation. Carrefour was its competitor, but at the same time they held the share that once belonged to Promodès. To solve this conflict of interest, Sonae bought the remaining of the company which since then belongs since then entirely to the Sonae group. In 2006, Sonae Distribuição invested about 206 million euros into 87 new stores, an increase of 10% to 543,000 m² of total area.

So, by June 2007, Sonae Distribuição had 391 shops, under brands like Worten (home equipment and electronics), Modalfa (clothing), Sportzone (sports), Vobis (computers and related products) or Star (travel agencies), among others. ⁽⁶⁾

	Openings in 2006	Total stores
Food related retailing	11	124
Continente	-	19
Modelo	11	80
Modelo Bonjour	-	25
Non Food related retailing	76	356
Worten	14	87
Modalfa	12	70
Sportzone	7	48
Vobis	-	21
Maxmat	1	21
Zippy	3	11
Star	2	61
Area Saude	26	26
Worten Mobile	11	11

Figure 7 - Expansion of the number of stores from Sonae Distribuição.

Source: Sonae 2006 Annual Report

Their human resources represent 70% of the whole group, which means there are over 21,000 people employed in Sonae Distribuição.

Sonae Distribuição generated, in 2006, a revenue of 3.1 billion euros, an increase of 13 % compared with the previous year and mostly stimulated by the opening of new stores (more 43,000 m²) and the broadening of the services provided by Modelo Continente. The operational cash-flow of 254 million euros represents an increase of 8% from the previous year. The net income increased by 29% from 125 million euros in 2005 to 160 million in 2006. By the end of the year, the financial debt was 377 million euros and about 1.5 times the EBITDA.

In their 2006 annual report, Sonae expressed the intention of keeping the leadership in the Portuguese market through an increase of more than 10% of the retailing area. For 2007, Sonae was planning on opening 10 food related stores, exploring new types of stores and new geographies. [15]

5. Auchan Portugal

Auchan Portugal is the Portuguese subsidiary of the multinational French-based group Auchan. They're represented in the Portuguese food-retailing market through the hypermarket and supermarket brands Jumbo and Pão de Açúcar. In 2007, two more Jumbo hypermarkets were opened (Viseu and Torres Vedras), raising the total number of stores to 19. One of the strengths of the Auchan's hypermarkets in Portugal is the broad choice between 4,500 high-quality own-brand products. The attention put in some new trendy niche products is also one of the factors that distinguishes the hypermarkets of the group. Both Jumbo Almada and Alfragide opened new areas specifically for organic products that came from many regional suppliers. Something similar was also started in Viseu and Torres Vedras to be dedicated to fresh products, mostly fruits and vegetables, from small local suppliers. Portuguese stores also support many Fairtrade grocery products and they were selling 40 products of this type by 2007. Still, in that year, Jumbo launched their online shopping site, offering 20,000 food products. Auchan also introduced a new concept, the Box, a store that is dedicated exclusively to electronic and technology products and that is located next to 14 of the 19 Jumbo hypermarkets. Also since 2007, customers were able to buy mobile phone call time at the checkout. The expansion of the range of services offered was also under consideration, with optician services planned to start in 2008. 2007 was also the year when the construction work that converted Jumbo Alfragide into a full size shopping center finished. In 2006, Auchan Portugal made 1.2 billion euros in sales. [2][3]

6. Jerónimo Martins

The Jerónimo Martins group is a Portuguese retail and wholesale group that is also present in the Polish market. In 2007, the group had 5.35 billion euros in sales value, 21.4% more than in 2006, but only 40% is estimated to be from the Portuguese food retail operations, Pingo Doce and Feira Nova. Jerónimo Martins also employed 41,300 people, 19% more than in the previous year. In 2007, the group made 131 million euros in profits, 13% more than in the year before. The company also has an industrial partnership with Unilever, which is in the maturity stage and generating cash inflows.

The Portuguese portfolio of Jerónimo Martins consisted in Pingo Doce (210 supermarkets in Portugal and 13 in Madeira), Feira Nova (9 hypermarkets and 37 mini-hypermarkets) and Recheio (31 cash & carries and 3 food platforms). Jerónimo Martins was, in 2007, the leader of the supermarket and cash & carry segments. The company recruited 2,700 people in that year. The product range developed by the food-retailing brands of the group had been recognized as high quality and innovative, with an effort to make them useful for both Pingo Doce and Feira Nova to increase scale and efficiency. In 2006, Pingo Doce own brand released new products for lactose-intolerant people and in 2007 they were pioneers by introducing the first own-brand biological products in the Portuguese food-retailing market. Considering the total area of the stores, Pingo Doce had a total of 184,000 m², Feira Nova had 172,000 m², Recheio had 110,000 m² and the operations in Madeira only 15,000 m².

In Poland, the group is represented through the brand Biedronka, a food-related chain of stores. In 2007, Biedronka had 1,045 stores in Poland and a sales value of 2.4 billion euros. The activities in Poland represent nearly half of the share in group sales (44.7%) and in employees (46.8%).

In Portugal, the Jerónimo Martins group has also a branch dedicated to marketing services, representations and restaurants. Through Jerónimo Martins Distribuição de Produtos de Consumo, the group represents some important international brands related to food products or comestics. They also own the Hussel chain, specialized in selling all types of chocolat and they also own restaurants and coffee shops in Portugal like Jeronymo, Ben & Jerry's, Olá and Subway.

From 2006 to 2007, the group's debt increased from 506 to 579 million euros (+14.4%) and it represented roughly a ratio of 1.7 of 2007's EBITDA. The margins were higher in consumer retail (7%) than they were in the cash & carry format (6%). [8]

7. The deal

Until the first official communication, there was a lot of speculation regarding who might be interested in buying the Carrefour hypermarkets. Some companies categorically declined their interest while others remained silent. Auchan, pointed out in the beginning as one of the most probable buyers, came out declaring that they had absolutely no interest in the Carrefour operations [9], while Sonae and Jerónimo Martins opted for not making any public declarations regarding their interest in the sale. There was also the speculation of foreign multinational groups that may be interested in entering the Portuguese market, such as Walmart. Carrefour announced that they would only sell the totality of the hypermarkets and by a fair price. Since they are in a comfortable position in terms of cost/benefit ratio within the group and the sale is only being considered since Portugal is no longer strategic, they can afford not selling right now. According to the *Diário Económico* analysts, a fair price for the Portuguese operations of Carrefour would be a value around 600 million euros. [14]

By July 2007, and after considering all the bids, Carrefour closed the deal with Sonae Distribuição for 662 million euros, 1.25 times the revenue of Carrefour in 2006. With this sale, Sonae Distribuição added to their assets 12 hypermarkets, 11 licenses to open new ones and 8 petrol stations. During the press conference that made it public, Nuno Jordão, CEO of Sonae Distribuição, stated that with those assets their market share would increase from 25% to 29.6% by itself, without even considering Sonae's expansion plans.

The intention to buy was planned to be delivered to the Portuguese competition authority within a few days, but Nuno was confident that there was no reason to be concerned about it being denied. By the end of August, Jerónimo Martins declared that the company had no interest in the business and was not going to declare itself as an interested party. [10] Alexandre Soares dos Santos, CEO of Jerónimo Martins, also declared that he would rather have a big Sonae than a big Carrefour, stating that the dimension of the Portuguese players is critical if they want to be competitive abroad. Carrefour and Auchan make deals at a global scale and bring very competitive prices to Portugal. Sonae and Jerónimo Martins need that size too. He also defended that a larger market share is not a problem if the company does not abuse its power within the national market, giving a hint to the regulator to let it happen but to keep an active monitoring of potential abuses. [11] Only Portugal Telecom and Centromarca had declared themselves interested in the process and only to them was given attention by the regulator. By December, the Regulator authorized the deal but imposed some restrictions. To avoid too much dominance from Sonae Distribuição in certain areas, some stores

must be sold to competitors or their area should be significantly reduced. Restrictions to the future growth are softer restrictions applicable if the dominance is not too dangerous to the competitive environment of the region, for example:

- In municipalities like Montijo, Barreiro and Seixal, Sonae cannot increase its food retailing area more than 14,000 m² and has to keep the total area under 50,000 m².



Figure 8 - Location of the nearest equivalent competitors' stores near Carrefour Montijo

- In Porto, Penafiel and Paços de Ferreira, where Sonae already had a very dominant position, it was imposed a total reduction of 10,600 m² in store area, 2000 in Paços de Ferreira and Penafiel and the remaining in Porto. This can be done by closing or selling hypermarkets, by reducing the store area in several ones or by reconverting it into non-food retailing area. In Porto was enough for Sonae to close one Modelo supermarket in Valongo and to reduce by 2000 m² an already approved project of opening a new one. In Viana do Castelo, Sonae was forced to sell the project of a 6.000 m² hypermarket to a competitor.
- In Portimão, there had to be a similar correction like the previous one, where Sonae had to opt for selling a Continente or Carrefour hypermarket, or a Modelo supermarket. In the last case, due to the smaller dimension of this store compared with the other two, Sonae would also have to sell an additional 1000 continuous square meters that belonged to one of the adjacent stores, either a Modalfa (clothing) or a Worten (electronics).



Figure 9 - Location of the nearest equivalent competitors' stores near Carrefour Portimão

- In Coimbra, a similar situation to Portimão occurred, but in this case Sonae had the choice of only selling an approved license and a couple adjacent non-food retailing stores, without having to sacrifice one of the currently operating Modelos, Carrefours or Continentes.

If Sonae cannot meet the requirements in time, the Authority would have to nominate an entity to alienate Sonae's assets. Sonae is also forbidden to request any new licenses to modify any existing stores with the purpose of increasing sales area, in the regions that had restrictions imposed by the Regulator. This does not include any already approved licenses or any non-food retailing stores. [6]

Sonae did not wait for the official decision of the regulator to start preparing the transition, since after the decision being made public they had a short period of time to make it happen. It started in August 2007, when a team composed by elements of both companies was created to ensure a peaceful and smooth transition from the Carrefour organization and culture to the one practiced by Continente. By working together, people from Carrefour are more aware of what might be a problem in such transition, detect and act quicker in any situation, and people from Continente can help because they naturally are more conscious of what and how the new people are likely to be integrated. With this approach, Carrefour elements make the detection and action on the problem easier and Continente employees come to the solution quicker. This type of approach is especially useful when dealing with the intermediate layers inside a Carrefour store, since they used to have much more autonomy than a traditional Continente store. By changing most of the decision-making power from the store to the headquarters, many roles and job functions from intermediate position employees may have to be redefined. This is a critical situation where employees can find the teams useful, since they can trust on ex-Carrefour people to stand by their side and helping them and they can rely on the Continente employees' expertise to know where they may fit better inside the new organization. Regarding the more operational workers, i.e. stock replenishers, etc, there is not much concern in this situation since they would do roughly what they had been doing until then. The team

is also a helpful tool to facilitate the communication between the top management and the decision-makers to the rest of the hierarchical pyramid.

Regarding the retention of the employees, it was always stated since the beginning that no one would be fired. The new hypermarkets could keep the same employees, and in some specific cases where there was overlapping of functions, the new employees would be integrated somewhere in Sonae's structure and within their competence area. Nuno Jordão claimed that the 27,500 employees (25,000 from Sonae and 2,500 from Carrefour) would not be sufficient to fulfill the needs of Sonae's expansion plan for the next few years, since they are expecting to recruit 6,000 new employees, so they should not be worried because no one would be fired. In fact, Sonae recruited 575 employees to reinforce the service level. When the reopening was to happen, Nuno wanted a reinforcement of the store service, mainly in the checkout and service sections. He also made a speech directed not only to the Carrefour employees, but also to his, informing that the careers from that moment on would evolve in a meritocracy basis, regardless of where any employee came from. Sonae's key performance indicators were also redefined, as well as the employees' incentive system, to adapt the structure to the new employees. In fact, Sonae even adopted some of the Carrefour good practices, which was very useful to boost the new employees' confidence and trust. The fact that the regional headquarters that controlled the Portuguese operations were located in Spain, those same people were kept in the Carrefour structure.

In the fourth of January of 2008, the twelve hypermarkets opened for the first time under the Continente brand. The employees of the ex-Carrefours spent the previous two days receiving education in order to smooth the transition from the Carrefour organization into a Continente type of organization. [13] This is especially critical, since it may appear almost the same store for the clients, but it certainly wasn't for the employees. Carrefour worked as a net of relatively independent units, so each store had their own local suppliers and stock their own products, operating in a decentralized model. Sonae operates in a centralized one, which means that the purchases are made centrally and most of the stock is also kept in central warehouses and not in the stores. This requires a different type of organization and operations management, which means that the people responsible for these tasks inside each Carrefour unit will have to learn quickly to make the transition with the less flaws possible. The stock management and employee management systems are also surely different, so accounting and administrative tasks inside the Carrefour units also have to be well monitored and controlled to ensure that the data quality doesn't decrease substantially in the first weeks. It is in situations like this that the mixed teams really come in handy. Because the differences for the customers may be small but noticeable and Sonae wants to make them feel as home as they

can be, a brochure explaining all the changes that happen in the stores was made and distributed in all ex-Carrefours within the first days of rebranding.

Also, by the end of 2007, Jerónimo Martins bought the hard discount chain Plus, both in Portugal and Poland, and has now 20% of market share in Portugal. Together with Sonae, they now represent more than 50% of the domestic market. The third player is still Auchan, but far behind with only 10% of market share. [14]

Relevant Theory

By definition, a merger occurs when two or more companies are combined into a single organization, and an acquisition happens when one company buys a business unit from another company (Wendi L. Adams, H. Alan Love and Oral Capps Jr., 1997). Motives for mergers and acquisitions usually fall under four categories:

- Efficiency gains: happens when a firm is trying to take advantage of another firm in the industry that is operating below its optimal capacity. Primary cost reduction can be obtained from the indivisibility of the overhead, asset fixity or specialization of the manpower. Further cost reductions can come from the reduction of bureaucratic and transportation expenses. Tax reductions can also be achieved through tax credit or accumulated tax losses.
- Managerial motives: managers are looking for maximizing revenue and growth and consider acquisitions as a cheap way to achieve it, specially in foreign markets. These operations are also a way to diversify and to decrease the overall risk level. By growing the company, managers also take advantage of an increased sphere of influence and higher salaries.
- Monopolistic motives: profitability and dominant size are considered the basic merger motives (Goldberg). The strong relationship between increased market share and increased profits is highly accepted. If a considerable number of players in a certain industry merge, the new company will face less competition and end up with more market power (Carlton and Perloff). As result of the cost reduction collusion, these markets can become more difficult to enter to new players.
- Speculative motives: happens when the buyer considers the price asked from the company that is being acquires a bargain.

According to Pedro Pita Barros, Tiago Brito and Diogo Lucena (2006), the retail management main concern is with managing cost structures. As result, one of the main reasons behind mergers and acquisitions is the maximization of buying power through scale and efficiency. The merger between retailing companies carries specific issues that are not a concern in other industries.

- First, the firms that will merge are likely competing for the same customers. As a result, the merger will decrease the competition for those clients, which will lead to an increase in the final prices.
- Secondly, the post-merger firm may also take advantage of an increase in their bargaining power vs. suppliers, which will lead to the acquisition of products at lower prices than

before. Although the advantages may be split between the company and the customers, the local authorities may object, although in recent years there were cases where they approved mergers that included a dominant position of the new firm in the selling and procurement market.

When studying the welfare effects of mergers in retailing, a theory that goes back to Galbraith (1952) defends that the countervailing power of the buyers allows them to mitigate their biggest suppliers power. Countervailing power is when one group balances the market power of another one, in this case customers and large retailing companies.

The increase in prices due to market concentration affects the price through two dimensions:

- When a small group of companies dominates a market, there is a higher risk of cooperation.
- A restrict number of firms will profit more for a given increase in price, since each of them has an higher demand than if the total number of companies in the market were higher.

The increase in buying power can come from two reasons:

- A larger buyer implies a lower cost for the supplier, assuming that selling the same total quantity for multiple buyers requires more resources than selling it to only one
- Since the buyer depends on the supplier to give him the product and the supplier depends on the buyer to sell it to the final customer, both parts need each other. In this case, the power each part has depends on the cost of replacing the other one. If a buyer grows in size and the total number of buyers decrease, that cost increases for the supplier and that gives more power to the buyer.

Case Analysis and Teaching Notes

1. What were the main reasons for each company to consider acquiring Carrefour?

The acquisition of the Carrefour operations allowed every one of the contenders an immediate expansion in its segment. The stores could be converted to Continente, in the case of Sonae Distribuição, Feira Nova, in the case of Jerónimo Martins, and Jumbo in the case of Auchan. With the proximity factor gaining more relevance every day, it is possible that in most cases where a Carrefour store is near one of the buyer's stores, the geographical dominance can be enough to balance the natural cannibalization between those two stores. There won't be just another store from the buyer's brand but also less competition in that particular region. Those two effects together can compensate the clients that already shopped in the buyer's first store that will migrate to the new converted Carrefour. It probably will not balance completely, since the sales of the two stores combined are likely to decrease, but it probably will not be enough to have a huge impact in the deal if these cases are not in the majority of the regions. In this case, Sonae Distribuição had an advantage over the remaining competitors: they could, if they intended to, convert the new stores into non-food retailing, or diminished their food retailing surface and turned them from an hypermarket into a supermarket plus two or three non-food retailing stores. With the launch of the Box brand by Auchan, this would also had been a scenario for them to consider, even though their non-food retailing portfolio is considerably smaller than the one from Sonae Distribuição. Other advantage that the geographic proximity could bring would be the access to legally restricted areas, where the population density is so high that would be impossible to buy enough area to build a hypermarket from scratch. Areas like this are just not relatively protected from more competition by the lack of free land, but their also located near much more families than a store in a less crowded area would be. This means, more clients per store.

When looking at the locations of the Carrefour stores and where most of the competitors had their own stores at the time, we can see that in most situations, Sonae already had a store nearby, on a couple of situations just a few hundreds of meters away. On the other hand, the other two competitors but mostly Auchan, had their locations much further away. This was a predictable scenario since it is already known the difference in size between the number of stores of the market

leader and the others. By having their stores at the time more further away than the other competitors, Auchan should value the Carrefour network higher than the other two, since they would benefit more from the new area of influence. With the same purpose but in a minor scale, Jerónimo is in the same situation. Sonae would clearly benefit from the acquisition, although with a much lower marginal gain than the other two. Even knowing that they could prevent the competitors to enter in some saturated and profitable locations, it is considered that it wouldn't be enough advantage to overcome the expansion in area of influence.

The quick expansion through the acquisition of new stores is a safe way to improve their market share. The dimension of the Portuguese Carrefour was enough to affect significantly the ranking of the main food retailers in Portugal. With sales in 2007 of approximately half of a billion euros, the acquisition of Carrefour, even without considering gains in scale, would be enough for Jerónimo Martins to overcome Sonae Distribuição and establish themselves as the market leaders in sales. Auchan would benefit by overcoming Intermarché and ending up in third place, really close to Jerónimo Martins. Sonae would reinforce the leadership of the market, increasing the gap versus the second player Jerónimo Martins, and become the only Portuguese retailer with sales over 3 billion euros. This analysis is done assuming everything else remains constant, but to make it more realistic one should also consider positive effects in the profit, like increase in negotiation power or brand strength, and negative ones, like cannibalization or loss of clients that wouldn't keep shopping in the same stores with the new owner and brand. By these parameters, the one that would benefit the most with the acquisition would be Auchan again. They had a real shot at growing about 50% in one year and finally be in a position where they could gain scale and fight for the market leadership. They would also be avoiding getting even further away from the top and seeing their ability to reach the top of the market being significantly decreased. The second that would benefit the most with the acquisition would be Jerónimo Martins again, they had the opportunity to finally overcome Sonae and become the market leader. Sonae will be the one that would benefit less with the acquisition.

By expanding by acquisition, every group could also benefit from cost reductions based on the improvement in secondary activities, such as transportation and distribution, and also on back office departments. By optimizing the transport and distribution routes and distribution centers together, the old ones and the new ones, the associated cost per product is likely to decrease through the increase in the optimization of the resources. Worst case scenario, their optimization as a whole is the same as optimizing them separately, in which case the cost per product would remain the same. Following the same analysis, the optimization of the back office services, such as administrative departments, law, accounting, marketing, sales, etc., is likely to reduce the overhead cost of the goods sold. Surely the original departments will not have the capacity to handle all the new inflow,

but there may be the possibility to cut a considerable part from the acquired company. There will be no need for two CFO's or directors of marketing, for example, or there may be a margin to improve the productivity of the resources from the acquirer by handling part of the business from the target company. The spare resources may be fired or kept in the company through the reallocation to other activities or by filling the need of new people that otherwise will be recruited from the job market, if the company is growing enough to incorporate them. In what gains in scale is concerned, the rank of who would benefit more and who would benefit less is not as simple to do as before. The smaller player has more to gain because the increase in size is relatively higher. Gains in scale have always more impact when the organization is small and they diminish with the increase in the company size. There may be a point when the company is so big and so complex that if it grows, it will not benefit from but rather lose. It may get to the point that the organization is so complex and so big that it does not have the ability to quickly react to market changes and become unmanageable. None of these companies is that big, but the smaller ones would still benefit more from the increase in size, like Auchan. The price to pay for these higher margins for profitability is a higher risk. Growing 50% like the Auchan group would be completely different than growing like if it was Sonae. The increase in complexity would be much higher and much more things would be new for the management. That would be a challenging "digestion". Again, it is considered that the advantages for the smaller players would be worth the risk, so Auchan would benefit much more, followed by Jerónimo Martins and then Sonae. The gap between them would be much smaller than in the previous analysis because of the risk that such an expansion carries.

By buying the existent stores from Carrefour, there are also managerial advantages besides the gains in efficiency stated before. The acquirer is buying already existing stores, which means that besides the faster process of starting to sell in those surfaces, there is much less risk in the process. These risks may include the possibility of being denied the construction on a planned location, uncertainty about the duration and cost of the bureaucracy, uncertainty about the cost and duration of the construction work, etc. There is also interest of the upper management to grow by acquisition: their influence and importance would increase faster, since they would become responsible for a larger area, more revenue and more people, which means a raise in their social status and salaries as well.

Another reason for acquiring Carrefour is if the sale price is considered a bargain. It was the Carrefour group that had the initiative to sell, so it is probably a situation in which the seller is the weakest link. If there would be an initial interest by any of the buyers, the seller would be in a much better position to ask for a higher price. Factors that may affect the valuation of the Portuguese operations of Carrefour may include the price of the land where the stores are built, as well as the

value of the infrastructures for the buyer, the know-how and skills of the employees and the amount and value of the customers that are likely to remain shopping in those locations after the sale.

Considering the second half of the deal, the gas stations, the company that would most definitely benefit the most would be Auchan. They already had several stations that belonged to the group, for example in Jumbo Almada, and the ownership of this business is something they already do. It would only be an expansion of their current business model. Next, there is Sonae Distribuição. They do not own any gas stations, but they had a partnership with Galp, in which stations is possible to have discounts on gas if the customer presents a receipt that proves that he spent a considerable amount in a Continente store in the previous days. Even not being the exact same model and not knowing for sure how Sonae and Galp split the costs of this promotion, it could be interesting for them. Sonae could own this part like Auchan does with their stations or they could get Galp to pay for that side of the business and keep the same model as before. The second option seems more viable since the first one would imply two simultaneous models and generate a conflict of interests between the own stations and the Galp ones. Jerónimo Martins is still in the very beginning of this business, with a partnership with Prio Energy, with the opening of their first station in 2007. Since they are still experimenting, they may not feel comfortable to expand that much in so little time, so Prios could step in and handle that part of the deal. The situation is very similar to Sonae, except they are already in a much more advanced stage of the partnership with Galp.

2. What are the main reasons not to acquire Carrefour?

In this situation, since it is just the sale of the structure and not the brand or portfolio, there are not many of the usual problems regarding mergers and acquisitions. When there is an acquisition there is the need to incorporate the target company into the acquirer. In this case, since this is an horizontal acquisition, the difference between employees is much less than if it was a vertical acquisition, since they are dealing with the same activities. Because the brand is not going to be sold, only the stores and the staff, there is no issue about merging the portfolios and how the new company will look like and how is it going to affect their identity. In terms of culture, there may be some significant differences that may cause a not so smooth transition in some situations. Carrefour is known to have a high degree of independency and autonomy from the headquarters and taking that away from the management will probably make them not wanting to work for the buyer. Sonae already is the market leader and accomplished that by growing organically. They had a model that worked and decisions that were well made. They would have to incorporate in this well made work something

that wasn't conceived by them and that is a risk that would clearly lower the value of the Carrefour network for them. Auchan worked in a similar model as Carrefour, so, in this case, they would be the best option to minimize cultural differences and keep the old management. The company culture may not be the only people-related problem, there is also the number of employees that were working for Carrefour at the time. In this case, Sonae is better positioned to avoid this being a problem due to the fact that the Carrefour staff dimension fits their growth plans for the short term. For the other contenders it would be a little bit harder to incorporate Carrefour staff, since they are smaller, and as a result the Carrefour is relatively bigger to them than it is to Sonae, and their expansion plan is not as aggressive.

Other thing that has to be considered while planning on an expansion is the availability and the minimum return on the invested capital. The decision of spending around 600 million euros is not one that one does without considering all the factors and alternatives, even for big groups like the ones we are considering in this deal. In 2007, the total investment of the Auchan group was 337 million euros. The sale of the Carrefour alone would be roughly twice the investment that they ended up doing. Considering that Auchan Portugal is part of the group Auchan, the independence to decide on the investment by the Portuguese branch is way smaller than a Portuguese based company. By being part of a much bigger multinational group, the headquarters have many faster growing markets that demand less cash at a lower risk. The Portuguese branch had to compete for investment with other fast growing markets that demand heavy investments, like China. This situation makes the investment in Portugal much more expensive and difficult. In 2007, the headquarters were planning to invest in the short-term in 50 new hypermarkets and 35 new supermarkets in Ukraine and Russia. This being their big investment of the year, and considering that they opened two new Jumbo hypermarkets besides the construction of Alegro Alfragide and Castelo Branco, there is not much room to spend nearly 600 million euros. With such low market share and losses in their assets value, Portugal is not a well positioned market to receive an investment of such value.

Jerónimo Martins, even though it is a Portuguese group, has also investments in other regional markets, more precisely in Poland. The same logic that was applied to analyze the decision-making process of Auchan can also be used, considering the differences, to analyze the Jerónimo Martins case. Considering the exhibit 1, both the Portuguese reality and the Polish can be compared. In total sales, the sum of all the Portuguese revenue is still higher than the Polish (2.7 billion euros vs. 2.4 billion euros), but the Polish market was a better market to invest at that time. The growth relatively to the previous year was much higher (39.5%) than any of the operations in Portugal, where some of them had nearly no growth at all. Their average sales per square meter, 9,000€/m², are more than

twice the average Portuguese sales and their like-for-like variation of the sales was much higher than the national sales, with some of them on the negative. All this means that, although the Portuguese revenue is still higher, the return on the investment in Poland is much higher than in Portugal. If it is to invest nearly 600 million euros, it would be a better option to inject most of it in the Polish operations. On top of that, Biedronka is the market leader in Poland and that market is on an earlier stage than the Portuguese. In Portugal, Jerónimo Martins is only the market leader in the supermarket segment (Pingo Doce) and in the cash & carry (Recheio) but it is only third in the hypermarket segment. The effect of such investment in the hypermarket segment in Portugal would be much lower than if it was made in the Polish food retail, because the Portuguese market is in a later stage. In Poland, Jerónimo Martins is in a very good position to guarantee the market leadership until the market slows and turn Biedronka into a cash cow.

3. Which company would benefit the most from the purchase of Carrefour?

To better summarize the analysis that was done previously and easily seeing the big picture, the considerations and evaluations made before can be put into a table:

Dimensions	Auchan	Jerónimo Martins	Sonae
Location	+++	++	+
• Cannibalization risk	+++	++	+
• New markets	++	+	++
Market Position	+++	++	+
Gains in Scale	+++	++	+
Investment alternatives	++	+	+++
Gas stations	+++	+	++

Figure 10- Advantages and disadvantages of buying Carrefour

The best placed into each category will be given +++, the second one ++ and the last one +. The scores were given according to how each dimension affects positively the value of Carrefour for each one. For example, scoring the highest in cannibalization risk means that the company with that

score has the lowest risk of the three. The final result will be the sum of location, market position, gains in scale, investment alternatives and gas stations. The categories analyzed are:

- Location - divided in how the buyer will suffer from sales cannibalization if the new stores are too close the old ones, and new markets to evaluate the benefit of expanding to new regions, particularly those that already are saturated and it is very difficult to enter. With a higher risk in the cannibalization there is Sonae, where most of the Carrefour stores are dangerously near to one of their own, with a couple of exceptions like Vila Nova de Gaia, that is a perfect example of expanding to new but saturated markets. The location overall score already contains the two categories.
- Market position - evaluates the benefits of the increase in size. Since Sonae is already the market leader and the biggest of the players, they would not benefit as much as Auchan, that would have an increase in size that would generate more power (bargaining power, market dominance, etc...) of them all.
- Gains in scale - evaluates how each company would benefit from the gains in scale that would come with the size increase. As seen before, the gains are higher for smaller companies.
- Investment alternatives - considers how good are the investment alternatives within each group. Groups with profitable investments in fast growing markets are less willing to invest in the Portuguese, so they would score less.
- Gas stations - considers how good the gas stations network would fit each company.

By summing up all the scores, Auchan is considered the most interested with 14 points, followed by Jerónimo Martins and Sonae with 8. Even considering that all the dimensions have the same weight in the final decision, in reality it is known that the ones that can make or cost more money have more importance, and by those it is meant location, gains in scale and investment alternatives. If the first two clearly contribute to increase the gap between Auchan and the other two, the better investment alternatives may be enough to put Sonae ahead of Jerónimo Martins. With Biedronka doing so well in Poland and being so profitable, there had to be huge advantages that are not present in this deal to make Jerónimo Martins invest in Carrefour instead of Poland. For Sonae it would be a good deal since they could expand by the size that they had planned without much risk and much quicker.

Exhibits

		Sales/m ²	Sales 07 (in million euros)	Variation 07/06	LFL (07/06)
Portugal	Pingo Doce	6.7	1136.8	17.5%	8.7%
	Feira Nova	5	800.9	8.3%	-2%
	Recheio	5.7	626.1	4%	3.6%
Madeira	Pingo Doce	9	123.3	10.9%	12.7%
Poland	Biedronka	18.6	2393.3	39.5%	21.1%

Exhibit 1- Sales of the Jerónimo Martins group in 2007.

Source: JM 2007 Annual Report

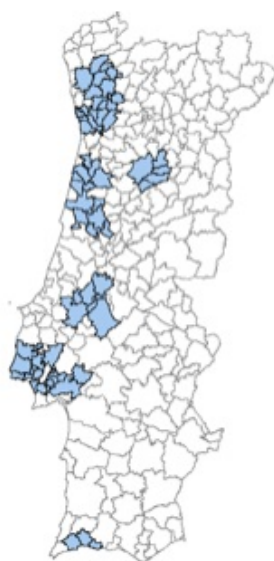


Exhibit 2 - Geographical Area of influence of the Carrefour stores.

Source: Competition Authority



Exhibit 3 - Distribution of the main retailers.

Source: Competition Authority



Exhibit 4 - Location of all the assets included in the sale.
Source: market regulator

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